United States General Accounting Office

GAO

Report to the Commander,
U.S. Army Materiel Command

September 1992

FINANCIAL MANAGEMENT

Weak Financial Accounting Controls Leave Commodity Command Assets Vulnerable to Misuse

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GAO

United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

B-248646

September 4, 1992

General Jimmy D. Ross
Commander, U.S. Army Materiel
Command

Dear General Ross:

We have conducted a comprehensive review of the U.S. Army's financial systems and operations. As part of our review, we evaluated the Army commodity commands' internal accounting controls. For fiscal year 1991, the commodity commands received about $6.5 billion in appropriated funds, primarily to procure major weapons systems, supplies, and spare parts. This report addresses internal control weaknesses in the accountability and control over resources at three of the six commodity commands—Aviation Systems Command, Missile Command, and Tank-Automotive Command.

Results in Brief

The commodity commands in our review did not effectively control and report on billions of dollars in assets for which they were responsible, nor did they accurately track and monitor billions of dollars in government owned materials and equipment which had been furnished to contractors. The amounts contractors reported for government furnished material differed by $1.4 billion from the amounts reported by the three commands. The commands did not determine the reasons for the differences in the commands' and the contractors' balances for government furnished material and equipment. In addition, we identified $1.1 billion of differences in government furnished equipment caused, in part, by two commands not having any accounting control over government furnished equipment.

The Army has continued to have a problem with large amounts of negative unliquidated obligations which occur when expended appropriations exceed recorded obligations for contracts or other purchases. This problem can be caused by overpayments to contractors or poor recordkeeping. Although Army Materiel Command officials have attempted to resolve these indicators of weak controls over appropriated funds, the balance of negative unliquidated obligations increased from $147 million to $260 million during fiscal year 1991. The Army said that about 16 percent of that amount was caused by overpayments to contractors, but commands had not recorded these amounts as accounts receivable, or determined their collectibility.

We also noted a major problem at the Commodity Commands' disbursing offices where blank checks and check signing machines were not secured, were accessible to anyone in the disbursing office, and were thereby vulnerable to misuse. During our review of the commodity commands' cash reconciliations, we found no instances of abuse or misuse of cash. However, given the sensitivity and negotiability of these assets, specific procedures should be implemented to minimize the risk of theft or fraud.

Background

The Department of the Army buys its weapon systems and related spare parts through the Army Materiel Command, which in turn purchases these items through its six commodity commands. Table 1.1 identifies the six commands and the commodities each manages.

Table 1.1 Commodity Commands and the Commodities Supported

Command	Commodities
Armament, Munitions and Chemical Command Rock Island, Illinois	Armament, fire control equipment, large and small caliber weapons, munitions - conventional, nuclear, and chemical
Aviation Systems Command St. Louis, Missouri	Army aircraft
Communications-Electronic Command Ft. Monmouth, New Jersey	Radars, computers, radios, and surveillance devices
Missile Command Redstone Arsenal, Alabama	Missile systems
Tank-Automotive Command Warren, Michigan	Ground mobility equipment, general purpose vehicles, construction, and materiel handling equipment
Troop Support Command St. Louis, Missouri	Troop support items, such as food, clothing, and field gear

According to an Army Materiel Command report, as of September 30, 1991, the commodity commands managed a wholesale inventory of about $37 billion composed of both equipment and spare parts. Commodity commands also accounted for disbursements of over $3 billion during fiscal year 1991, on procurement contracts.

Objectives, Scope, and Methodology

Our primary objective was to assess the commodity commands' systems of internal control. We performed this work in conjunction with our audit of the Army consolidated financial statements, undertaken pursuant to the Chief Financial Officers Act of 1990.

The specific objectives of this review were to

- determine if government furnished property was properly accounted for by the commodity commands,
- assess the status of the Army Materiel Command efforts to reduce and prevent negative unliquidated obligations from occurring, and
- assess the controls over disbursement operations at the three commands we visited.

In pursuing these objectives, we reviewed the commodity commands' financial management operations, including key internal controls which relate to recording, processing, summarizing, and reporting financial data. We held discussions with Army personnel at each of the locations we visited, reviewed pertinent documentation, and performed other audit tests of internal controls as we considered necessary.

Specifically, we reviewed the provisions of the Federal Acquisition Regulation regarding government furnished property. We also reviewed Department of Defense (DOD), and Army policies, procedures, related documents, and our prior reports concerning government furnished property. We interviewed command officials and personnel in the Army Industrial Engineering Activity Office to obtain the contractor reported balances and explanations for differences in the balances, respectively.

We interviewed Army Materiel Command officials and reviewed reports regarding the status of negative unliquidated obligations. We also reviewed Army regulations and prior GAO reports which discussed negative unliquidated obligations.

To assess the controls over disbursing office assets, we interviewed command personnel in the disbursing office and in the finance and accounting office. We also observed operations within the disbursing offices.

Our work was conducted at the Army Materiel Command, Alexandria, VA; and three commodity commands—Aviation Systems Command, St. Louis, MO; Missile Command, Redstone Arsenal, AL; and the Tank-Automotive Command, Warren, MI.

We performed our review in accordance with generally accepted government auditing standards. We performed our fieldwork from June 1990 to May 1992.

DOD provided written comments on a draft of this report. These comments are discussed in the agency comments section of this report and are presented in appendix I.

Government Furnished Property Is Not Effectively Controlled

Although we have reported on the Army's problems with government furnished property for many years, commodity commands continue to encounter serious problems in tracking and monitoring government furnished property located at contractor facilities. The commodity commands' records for government furnished property differed by over $2 billion with the contractor balances; yet the commands did not investigate and resolve these differences.

Government furnished property includes both government furnished materials and government furnished equipment. Government furnished material includes items such as components, assemblies, and raw and processed materials that will be used or consumed in the production of major military equipment such as aircraft, tanks, or missiles. Government furnished equipment includes equipment to be used to produce or test an item. Industrial plant equipment and special test equipment are examples of government furnished equipment.

The Federal Acquisition Regulation states that contractors are to provide all property needed for government contracts, except when it can be demonstrated that it is in the government's best interest to do so. Even when a federal agency does furnish property to a contractor, the agency has a responsibility to establish accountability and to exercise appropriate oversight and control.

Control Over Government Furnished Property Is a Long-standing Problem

Poor control over government furnished material and equipment has been a problem for the Army for several decades. In June 1986, we reported[1] that the services, including Army, had made little progress since the 1970s in implementing overall government policies which call for minimizing the amount of equipment the government furnishes to contractors. The major factors contributing to this condition included the continuing management

[1]Government Equipment: Defense Should Further Reduce the Amount It Furnishes to Contractors (GAO/NSIAD-86-109, June 19, 1986).

oversight weaknesses at field and headquarters levels over the acquisition, use and retention, and disposal of this equipment.

The Army Materiel Command has identified the lack of control over government furnished property as a material weakness since fiscal year 1985. It reported in its fiscal year 1991 "Statement on Internal Management Control," dated October 7, 1991, that this lack of control remained uncorrected. In describing the weakness, the Army Materiel Command stated that the controls over government furnished material and equipment are not sufficient to ensure whether property has been used for its intended purpose or returned.

Under these conditions, there is no assurance that (1) the government's sizeable investment in such property has been adequately protected, (2) the government has not unnecessarily procured items, and (3) any losses of this property have also been accounted for.

Weak Control Over Government Furnished Material

We found differences between the commodity commands' general ledger accounts and contractor reported amounts of government furnished materials. We also found that key logistics information, such as consumption, meaning usage of government materials, is not accounted for by the commands. Army Regulation 37-1 requires that the accounting records be adjusted based on consumption data provided by the contractor. The Federal Acquisition Regulation requires contractors to report the amount of government furnished material they have on hand annually. This information should be forwarded to the finance and accounting office for posting to the general ledger. However, we found that in some instances this information is not provided to personnel in the finance and accounting office for posting to the general ledger. At the three commands we visited the general ledger accounts for government furnished materials differed from the contractors' reported balances by $1.4 billion as shown in table 1.2.

Table 1.2: Government Furnished Material Balances as of September 30, 1991

Dollars in millions

Activities	Command general ledger	Contractor reported	Difference
Aviation Systems	$1,571	$537	$1,034
Tank-Automotive	$55	$210	$155
Missile	$525	$314	$211
Total Difference			**$1,400**

These conditions are similar to problems with government furnished materials that we reported on[2] in March 1988. In that report we found that the Army had not developed an accounting system that would independently identify how much government furnished material the contractors had on hand and how it was being used. In commenting on a draft of that report, the Army stated on January 26, 1988, that the Army Materiel Command had developed a financial accounting system to identify how much government furnished material is in the hands of its contractors, how much is being provided annually, and how much has been used. The comments also stated that the system would be implemented by June 1989. As of April 16, 1992, the system had not yet been implemented. According to Army Materiel Command and Missile Command officials, the system has numerous unresolved, procedural, regulatory, and organizational issues delaying its implementation.

Several Factors Contributed to Differences in Government Furnished Material

Factors contributing to the differences in government furnished material accounts balances included lack of contractor reported consumption data, arbitrary adjustments of command government furnished material balances, and combined recording of government furnished materials and equipment in the general ledger account. Army Regulation 37-1 requires that government furnished material be continually accounted for, and that adjustments to the Army's accounting records be based on contractor reported consumption data and independently validated contractor inventories.

According to finance and accounting officials at Aviation Systems and Missile commands, they were not always provided data on the amount of material the contractors had used. To address the problem of growing balances, the Aviation Systems Command issued a memorandum on July 30, 1991, requiring that the amount of all government furnished material general ledger transactions over 15 months old be written off as an accounting loss.

Aviation Systems Command officials decided to implement this procedure on a quarterly basis. They told us that the command's assumption was that any item over 15 months old had been used by the contractor. Since the Aviation Systems Command performs accounting services for the Troop Support Command, it also wrote off over $803 million of government furnished materials transactions over 15 months old for them in

[2]Internal Controls: Status of Army Efforts to Control Contractor Access to the DOD Supply System (GAO/NSIAD-88-98, Mar. 11, 1988).

September 1991. In January 1992, Aviation Systems Command wrote off an additional $504 million in government furnished materials at the commands.

Arbitrarily adjusting government furnished material balances with contractors simply masks the command's lack of control over these assets and does not aid in resolving differences in balances. Periodically provided contractor consumption data coupled with independently validated inventories are the only reliable bases for recording and maintaining accurate balances for government furnished materials.

Personnel at the Aviation Systems and Missile commands also stated that government furnished equipment may be recorded in the government furnished material general ledger account. The financial systems do not distinguish between government furnished material and equipment within the general ledger account and, therefore, we were unable to determine the extent of any misclassification.

Weak Control Over Government Furnished Equipment

Army Regulation 37-1 specifies that government equipment supplied to a contractor should be accounted for in the commodity commands' accounting records. Further, the regulation requires independent verification of equipment held by contractors. In practice, this would require the commands to maintain independent records of government furnished equipment and periodically reconcile the command and contractor reported balances. None of the commands we visited followed these requirements of the regulation.

Contractor records showed over $1 billion in government furnished equipment owned by the Aviation Systems and Missile commands. However, these commands did not maintain a general ledger account for the equipment. Since these commands do not have government furnished equipment accounts, they have no basis for comparing or independently verifying the accuracy of contractor reported balances. Finance and accounting officials at these commands were unable to explain the absence of the government furnished equipment general ledger account.

The Tank-Automotive Command had a general ledger account for government furnished equipment but it did not serve as an independent record. Command procedures showed that the contractor's reported balance is the sole source of data for recording entries to the equipment account. However, as of September 30, 1991, the command's equipment account balance was $300 million while the contractor's reported balance showed $428 million—a difference of $128 million.

Two factors contributed to the difference. According to command officials, the difference may have occurred because (1) only government supplied industrial plant equipment and other plant equipment are included in the account balance, and (2) other government furnished items, such as special tooling equipment, were not included in the account even though they meet the definition of equipment in the Federal Acquisition Regulation.

We also found that the financial data on government furnished equipment were not recorded in the command's accounting records in a timely manner. The Army Industrial Engineering Activity, which compiled the data for fiscal year 1990, did not provide the information to the command until 8 months after the close of the fiscal year. As of April 1992, the Tank-Automotive Command had not been provided the government furnished equipment data for fiscal year 1991.

Negative Unliquidated Obligations Have Increased

When expended appropriations exceed the amount obligated, the resulting difference is called a negative unliquidated obligation. These can result from such factors as overpayments to contractors or poor recordkeeping. The total negative unliquidated obligation balance reported by the Army Materiel Command increased by $113 million to $260 million between September 30, 1990, and September 30, 1991, despite attempts by the Defense Finance and Accounting Service and the Army Materiel Command to reduce or prevent negative unliquidated obligations. We also noted that as of March 31, 1992, negative unliquidated obligations increased an additional $64 million to $324 million. The existence of significant amounts of negative unliquidated obligations is an indicator of breakdowns in an organization's controls over funds. Also, Army Regulation 37-1, "Army Accounting and Fund Control," requires that immediate corrective action be taken to resolve negative unliquidated obligations.

In May 1990, we reported that the Army was not aware of its large negative unliquidated obligation balances.[3] At that time we found that as of September 30, 1989, Army Materiel Command had about $328 million in negative unliquidated obligations on its books. The Materiel Command managed to reduce the negative unliquidated obligations balance to

[3] Financial Management: Army Records Contain Millions of Dollars in Negative Unliquidated Obligations (GAO/AFMD-90-41, May 2, 1990).

$147 million by September 30, 1990. However, over the next 12 months the negative unliquidated obligations balance increased by $113 million to $260 million. The fact that the command's negative unliquidated obligations increased is particularly disturbing in view of DOD commitments to control them. The Department of Defense concurred with the findings in our May 1990 report and stated that it would take actions to (1) determine the control weaknesses that have caused the negative balances, and (2) require installations to report these balances on a quarterly basis. However, these attempts have failed to control the growth of negative unliquidated obligations during fiscal year 1991.

Overpayments to Contractors and Accounting Errors

The Army Materiel Command attributed over $41 million, or 16 percent of its negative unliquidated obligations, to overpayments to contractors and the remaining $218 million to other causes, including accounting and processing errors. Negative unliquidated obligations can affect the Army adversely if prompt corrective action is not taken. For example, the longer overpayments remain undetected and no collection action is taken, the greater the chances of events occurring that would prevent recovery. At a minimum, overpayments to contractors create interest free loans. Also, they preclude using these funds to meet other requirements. Payments charged to incorrect appropriation accounts and processing errors distort accounting reports that the Army and the Office of the Secretary of Defense use to make management decisions on the budget execution for individual appropriations.

Actions Not Taken to Collect Overpayments

With respect to overpayments, Army Regulation 37-1, "Army Accounting and Fund Control," requires overpayments to be recorded as accounts receivables and specifies that efforts should be made to recover these amounts. However, we noted that none of the overpayments included in the command's $260 million of negative unliquidations had been recorded as accounts receivable or analyzed to determine their collectibility. Our examination of the commodity commands' reports also showed that over $8 million of the overpayments might not be collected because several of the underlying contracts had been terminated for default or the performing companies had gone bankrupt.

Army Materiel Command Has Not Addressed the Reasons for Negative Unliquidated Obligations

Army Materiel Command officials told us that a major cause of negative unliquidated obligation balances is the ineffective communication of contract and payment information between the Commands' system and the Defense Finance and Accounting Service systems. According to the officials, both the contract information transmitted from the commodity commands to the accounting service and the payment information transmitted from the accounting service to the commodity commands are either inaccurate or incompatible. In this regard we noted that the accounting service's statistical report for the month of December 1991 showed that 58 percent of transactions related to contracts transmitted from the Army to the accounting service were incomplete and required correction and/or additional information.

Disbursing Office Control Weaknesses

Our work also showed that controls over blank checks and check signing machines were weak. Commodity Commands disbursed $3 billion during fiscal year 1991. The commands we visited generally maintained a supply of blank checks ranging from 30,000 to 100,000. Given the sensitivity and negotiability of these assets, specific procedures should be established which address the unique physical characteristics of each location. Although our review of the commodity commands' cash reconciliations did not disclose any instances where assets were misused, these control weaknesses increased the vulnerability of these assets to loss, theft, or fraud. Adherence to prescribed procedures would correct these problems.

Army Regulation 37-103 establishes requirements for safeguarding disbursing office assets. The regulation provides general guidance requiring finance officers to establish internal controls for checks used to disburse U. S. government funds. It specifically requires that blank checks, when not in use, be kept under lock and key in the safe of the finance officer or the deputy. Regarding the safeguarding of check signing equipment, the regulation states that the preferred method is to store the equipment in the disbursing office vault and that the disbursing officer or deputy should keep personal custody of the keys to the machine.

However, at the Missile Command, we noted that a box of unsigned checks remained loaded on a printer, ready for processing. Although the printer was located inside the disbursing office vault, the vault remained open throughout the business day. Further, boxes of blank checks, initially opened for inspection and taped shut, were stacked on the floor against a wall of the disbursing office vault. The open vault allowed unauthorized disbursing office employees access to the checks. A command official stated that he believed it was not practical to lock the vault during the day. However, he did agree to lock the disbursing office doors during the day and to lock boxes of unused checks in filing cabinets within the vault.

At the Aviation Systems Command, the keys to the check signing machine were kept in an unlocked safe inside the open vault and were thus accessible to most disbursing office employees. In addition, boxes of blank checks were stored on open shelves inside the disbursing office vault. As a result of our review, the Aviation Systems Command complied with Army Regulation 37-103 by locking the keys in a secured area inside the vault.

At the Tank-Automotive Command, we found that the disbursing officer, as standard operating procedure, left a box of blank checks at his desk unattended when he was away from the disbursing office area. As a result of our review, the disbursing officer agreed not to leave the box of unused checks unattended when he leaves the area.

Conclusions

Effective financial management requires strong systems of internal controls to safeguard and maintain accountability over assets. During our review we found pervasive internal control weaknesses at the commodity commands. These weaknesses affect Army's ability to maintain adequate accountability of (1) government furnished material and equipment, (2) negative unliquidated obligation balances, and (3) disbursing office assets.

Recommendations

We recommend that you take the following actions.

- Maintain separate ledgers for government furnished material and equipment and record what is bought and provided; require that contractor consumption data be certified by an authorized contractor representative, received by the command, and recorded in the general ledger; and require periodic reconciliation of commodity command and contractor government furnished material and equipment accounts at least annually.
- Direct Army Materiel Command leadership to determine the specific reasons for the negative unliquidated obligations contained in existing balances, resolve each one of them, prepare a corrective action plan to address systems and operating deficiencies that allow negative unliquidated obligations, and monitor progress to help ensure that corrective actions are taken.
- Require overpayments resulting from negative unliquidated obligations to be properly recorded in the accounting records as accounts receivable.

- Follow Army Regulation 37-103 procedures in each disbursing office to limit access to blank Treasury checks and check signing machines.

Agency Comments

DOD concurred with all of our findings and recommendations and described a number of corrective actions that it had underway or planned to initiate. Regarding the above four recommendations, DOD stated the following.

(1) The requirement to reconcile balances reported by contractors with DOD general ledger account balances will be addressed in the Department's procedures for preparing the fiscal year 1992 financial reports.

(2) The Joint Contract Accounting and Finance Process Review Group would continue its efforts to find, control, reduce, and correct the causes of negative unliquidated obligations. However, it acknowledged that previous efforts were not successful and is concerned about the rate at which new negative unliquidated obligations are appearing.

(3) The Commander, U.S. Army Materiel Command, will be directed to issue guidance by August 31, 1992, requiring that overpayments be recorded as refunds receivable in accounting reports as of September 30, 1992.

(4) By the end of October 1992, the Army Materiel Command will inform all disbursing offices of the related finding on blank check access and check signing machines and the corrective action required.

We are sending copies of this report to the Secretary of Defense, the Secretary of the Army, the Acting Comptroller of the Department of Defense, the Acting Chief Financial Officer of the Department of Defense, the Director of the Defense Finance and Accounting Service, and the

Director of the Office of Management and Budget. Copies will also be made available to others upon request. Please contact me or Terry Carnahan, Senior Assistant Director, at (202) 275-7095 if you or your staff have questions or wish to discuss matters contained in this report.

Major contributors to this report are listed in appendix II.

Sincerely yours,

David M. Connor

David M. Connor
Director, Defense Financial Audits

Comments From the Department of Defense

OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

(Management Systems)

JUL 31 1992

Mr. David M. Connor
Director, Defense Financial Audits
Accounting and Financial Management
Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Connor:

This is the Department of Defense response to the General Accounting Office draft report, "FINANCIAL AUDIT: Weak Financial Accounting Controls Leave Commodity Command Assets Vulnerable to Abuse," dated June 15, 1992 (GAO Code 917223), OSD Case 8674-K.

The Department generally concurs with the findings and recommendations in the draft report.

Detailed DoD comments on the report findings and recommendations are provided in the enclosure.

Sincerely,

Alvin Tucker
Deputy Comptroller
(Management Systems)

Enclosure

GAO DRAFT REPORT--DATED JUNE 15, 1992
(GAO CODE 917223) OSD CASE 8674-K

"FINANCIAL AUDIT: WEAK FINANCIAL ACCOUNTING CONTROLS LEAVE COMMODITY COMMAND ASSETS VULNERABLE TO MISUSE"

DEPARTMENT OF DEFENSE COMMENTS

* * * * *

FINDINGS

- FINDING A: Commodity Commands. The GAO reported that the Department of the Army buys weapon systems and related spare parts through the Army Materiel Command, which in turn purchases the systems and related spare parts through six commodity commands. The GAO found that, as of September 30, 1991, the commodity commands managed a wholesale inventory of about $37 billion--composed of both equipment and spare parts. The GAO observed that, during FY 1991, the commodity commands also accounted for disbursements of over $3 billion on procurement contracts. (pp. 3-4, GAO Draft Report)

Now on p. 2.

DoD RESPONSE: Concur.

- FINDING B: Control Over Government-Furnished Property Is a Long-standing Problem. The GAO concluded that poor control over Government-furnished material and equipment has been a continuing problem for the Army. The GAO referenced a June 1986 report, in which the GAO had reported that the Military Services--including the Army--had made little progress in implementing overall Government policies for minimizing the amount of equipment the Government furnished to contractors (OSD Case 6979). The GAO noted that the Army Materiel Command had identified the lack of control over Government-furnished property as a material weakness since FY 1985. The GAO further noted that, in the FY 1991 "Statement on Internal Management Control," dated October 7, 1991, the Army stated that the lack of control remained uncorrected. The GAO reported that, in describing the weakness, the Army Materiel Command indicated the controls over Government-furnished material and equipment were not sufficient to ensure whether property had been used for the intended purpose or returned. In summary, the GAO concluded that, as a result, there was no assurance (1) the Government investment in the property had been adequately protected, (2) the Government had not unnecessarily

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Now on p. 1 and pp. 4-5.

procured items, and (3) any losses of the property had been accounted for. (pp. 1-2, pp. 7-10/GAO Draft Report)

DoD RESPONSE: Concur.

- FINDING C: Weak Control Over Government-Furnished Material. The GAO found differences between the general ledger accounts maintained by the commodity commands and contractor reported amounts of government-furnished materials. The GAO also found that key logistics information, such as consumption, was not accounted for by the commands. The GAO pointed out Army Regulation 37-1 requires that the accounting records be adjusted based on consumption data provided by the contractor, and that Federal Acquisition Regulations require contractors to report the amount of Government-furnished material on hand annually. The GAO noted that the information should be forwarded to the finance and accounting office for posting to the general ledger. The GAO reported that, in some instances the information was not provided to personnel in the finance and accounting office for posting to the general ledger. At the three commands the GAO visited, the general ledger accounts for Government-furnished materials differed from the balances reported by the contractors by $1.4 billion.

  The GAO observed that the current findings were similar to problems with Government-furnished materials that were reported in March 1988 (OSD Case 7463). The GAO explained that, in the prior report, it had found the Army had not developed an accounting system that would independently identify how much Government-furnished material the contractors had on hand, and how it was being used. The GAO noted that, in commenting on a draft of that report, on January 26, 1988, the Army stated the Army Materiel Command had developed a financial accounting system to identify (1) how much Government-furnished material was in the hands of contractors, (2) how much was being provided annually, and (3) how much had been used. The GAO further noted that, according to the Army response, the system was to be implemented by June, 1989. The GAO found, however, that as of April 16, 1992, the system still had not been implemented. The GAO was advised by Army Materiel Command and Missile Command officials that the system has numerous unresolved procedural, regulatory, and organizational issues--which has delayed implementation. (pp.1-2, p. 8, pp. 10-12/GAO Draft Report)

Now on pp. 1, 4, and 5-6.

DoD RESPONSE: Concur.

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- FINDING D: <u>Several Factors Contributed to Differences in Government-Furnished Material</u>. The GAO concluded that several factors contributed to the differences in Government-furnished material accounts balances--including (1) lack of contractor-reported consumption data, (2) arbitrary adjustments of command Government-furnished material balances, and (3) combined recording of Government-furnished materials and equipment in the general ledger account. The GAO pointed out that Army Regulation 37-1 requires that Government-furnished material be accounted for continually--and that adjustments to Army accounting records be based on contractor reported consumption data and independently validated contractor inventories.

  The GAO reported that, according to finance and accounting officials at the Aviation Systems and Missile commands, data on the amount of material the contractors had used was not always provided. The GAO reported that, to address the problem of growing balances, the Aviation Systems Command issued a memorandum on July 30, 1991, requiring that the amount of all Government-furnished material general ledger transactions over 15 months old be written off as an accounting loss. The GAO learned that Aviation Systems Command officials implemented the procedure on a quarterly basis, based on the assumption that any item over 15 months old had been used by the contractor. The GAO further reported that, in September 1991 and in January 1992, over $803 million of Government-furnished materials transactions over 15 months old were also written off for the Troop Support Command; while the Aviation Systems Command wrote off an additional $504 million in Government-furnished materials at the commands. The GAO concluded that arbitrarily adjusting Government-furnished material balances with contractors simply masked the lack of control over the assets and did not aid in resolving differences in balances.

  The GAO noted personnel at the Aviation Systems and Missile commands stated that Government-furnished equipment may be recorded in the Government-furnished material general ledger account. The GAO explained that the financial systems did not distinguish between Government-furnished material and equipment within the general ledger account and, therefore, the GAO was unable to determine the extent of any misclassification. (pp. 1-2, p. 8, pp. 12-14/GAO Draft Report)

Now on pp. 1, 4, and 6-7.

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DoD RESPONSE: Concur.

- FINDING E: Weak Control Over Government-Furnished Equipment. The GAO explained that Army Regulation 37-1 specifies that Government equipment supplied to a contractor be accounted for in the accounting records of the commodity commands, and that independent verification be made of the equipment held by contractors. The GAO pointed out that would require the commands to maintain independent records of Government-furnished equipment and periodically reconcile the command and contractor reported balances. The GAO found, however, that none of the commands it visited followed the requirements of the regulation.

  The GAO also reported that contractor records showed over $1 billion in Government-furnished equipment owned by the Aviation Systems and Missile commands; however, the commands did not maintain a general ledger account for the equipment. The GAO concluded that, since the commands did not have Government-furnished equipment accounts, there was no basis for comparing or independently verifying the accuracy of contractor reported balances. According to the GAO, finance and accounting officials at the commands were unable to explain the absence of the Government-furnished equipment general ledger account. The GAO reported that, while the Tank-Automotive Command had a general ledger account for Government-furnished equipment, it did not serve as an independent record. The GAO explained Command procedures showed that the contractor reported balance was the sole source of data for recording entries to the equipment account; however, as of September 30, 1991, the command equipment account balance was $300 million, while the contractor reported balance showed $428 million--a difference of $128 million.

  The GAO further reported that, according to command officials, the difference may have occurred because (1) only Government-supplied industrial plant equipment and other plant equipment were included in the account balance, and (2) other Government-furnished items, such as special tooling equipment, were not included in the account--even though the items met the definition of equipment in the Federal Acquisition Regulation.

  The GAO also found that the financial data on Government-furnished equipment was not recorded in command accounting records in a timely manner. The GAO observed that the Army Industrial Engineering Activity, which compiled the data for FY 1990, did not provide the information to the command

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Now on pp. 1, 4, and 7-8.

until 8 months after the close of the fiscal year. The GAO further observed that, as of April 1992, the Tank-Automotive Command had not been provided the Government-furnished equipment data for FY 1991. (pp. 1-2, pp. 7-8, pp. 14-16/GAO Draft Report)

DoD RESPONSE: Concur.

- FINDING F: Negative Unliquidated Obligations Have Increased. The GAO reported that the total negative unliquidated obligation balance reported by the Army Materiel Command increased by $113 million between September 30, 1990, and September 30, 1991--i.e., up to $260 million--despite attempts by the Defense Finance and Accounting Service and the Army Materiel Command to reduce or prevent negative unliquidated obligations. The GAO also noted that, as of March 31, 1992, negative unliquidated obligations had increased an additional $64 million--to $324 million. The GAO concluded that significant amounts of negative unliquidated obligations is indicative of breakdowns in controls over funds.

The GAO referenced a May 1990 report, in which it had reported that the Army was not aware of the large negative unliquidated obligation balances (OSD Case 8258). The GAO had reported that, as of September 30, 1989, the Army Materiel Command had about $328 million in negative unliquidated obligations. The GAO found that, although the Army Materiel Command reduced the negative unliquidated obligations balance to $147 million by September 30, 1990--over the next 12 months, the negative unliquidated obligations balance increased by $113 million--up to $260 million. The GAO pointed out that the Department had concurred with its findings in the May 1990 report and stated that actions would be taken to (1) determine the control weaknesses that have caused the negative balances, and (2) require installations to report the balances on a quarterly basis. The GAO concluded however, that the attempts to control the growth of negative unliquidated obligations during FY 1991 have failed. (pp. 1-2, pp. 16-18/GAO Draft Report)

Now on p. 1 and pp. 8-9.

DoD RESPONSE: Concur. In response to the referenced May 1990 GAO report, the Defense Finance and Accounting Service and the Military Services formed the Joint Contract Accounting and Finance Process Review Group on June 28, 1991, to develop joint action plans with the objective of finding, controlling, reducing, and correcting the causes of negative unliquidated obligations. It is recognized

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that the current level of negative unliquidated obligations, at the Commodity Commands, does not show a significant reduction. However, of the $324 million reported as of March 31, 1992, approximately $173 million were under 90 days old. The high rate of new negative unliquidated obligations is of concern, and the actions of the Joint Group are being directed toward finding the causes and effecting improvements.

- FINDING G: Overpayments to Contractors and Accounting Errors. The GAO reported that the Army Materiel Command attributed over $41 million, or 16 percent of the negative unliquidated obligations, to overpayments to contractors--and the remaining $218 million to other causes, including accounting and processing errors. The GAO concluded that negative unliquidated obligations can affect the Army, as follows:

  - The longer overpayments remain undetected and no collection action is taken, the greater the chances of events occurring that would prevent recovery;

  - Overpayments to contractors create interest free loans;

  - Such funds are not available for use to meet other requirements; and

  - Payments charged to incorrect appropriation accounts and processing errors distort accounting reports that are used to make management decisions on the budget execution for individual appropriations. (pp. 1-2, p. 18/GAO Draft Report)

Now on pp. 1 and 9.

DoD RESPONSE: Concur.

- FINDING H: Actions Not Taken to Collect Overpayments. The GAO found that none of the overpayments included in the $260 million of negative unliquidated obligations had been recorded as accounts receivable or analyzed to determine collectibility. The GAO observed its examination of the commodity commands reports also showed that over $8 million of the overpayments might not be collected, because several of the underlying contracts had been terminated for default or the performing companies had gone bankrupt. (pp. 1-2, p. 19/ GAO Draft Report)

Now on pp. 1 and 9.

DoD RESPONSE: Concur. Action is being taken through the Joint Contract Accounting and Finance Process Review Group

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to report and validate contractor overpayments on the Defense Finance and Accounting Service payment office records. Validated overpayments are being established properly as accounts or refunds receivable.

- FINDING I: Army Materiel Command Has Not Addressed the Reasons for Negative Unliquidated Obligations. The GAO reported that, according to Army Materiel Command officials, a major cause of negative unliquidated obligation balances is the ineffective communication of contract and payment information between the Command system and the Defense Finance and Accounting Service systems. The GAO noted that both the contract information transmitted from the commodity commands to the accounting service and the payment information transmitted from the accounting service to the commodity commands are either inaccurate or incompatible. The GAO further noted that the accounting service statistical report for the month of December 1991 showed that 58 percent of transactions related to contracts transmitted from the Army to the accounting service were incomplete and required correction and/or additional information. (pp. 1-2, pp. 19-20/GAO Draft Report)

Now on p. 1 and pp. 9-10.

DoD RESPONSE: Concur. One of the objectives of the Joint Contract Accounting and Finance Process Review Group is to find reasons for negative unliquidated obligations and identify solutions.

- FINDING J: Disbursing Office Control Weaknesses. The GAO concluded that controls over blank checks and check signing machines were weak. The GAO pointed out that Commodity Commands disbursed $3 billion during FY 1991. The GAO reported that the commands it visited generally maintained a supply of blank checks ranging from 30,000 to 100,000. The GAO observed that, although the review of cash reconciliations performed by the commodity commands did not disclose any instances where assets were misused, the control weaknesses nonetheless increased the vulnerability of these assets to loss, theft or fraud. (pp. 1-2, pp. 20-22/GAO Draft Report)

Now on p. 1 and pp. 10-11.

DoD RESPONSE: Concur.

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RECOMMENDATIONS

- RECOMMENDATION 1: The GAO recommended that the Commander, U.S. Army Materiel Command (1) maintain separate ledgers for Government-furnished material and equipment and record what is bought and provided, (2) require that contractor consumption data be certified by an authorized contractor representative, received by the command, and recorded in the general ledger, and (3) require periodic reconciliation of commodity command and contractor Government-furnished material and equipment accounts at least annually. (pp. 23-24/GAO Draft Report)

Now on pp. 11-12.

  DoD RESPONSE: Concur. The DoD agrees that periodic reconciliation of financial and logistical records regarding Government-furnished material and equipment is beneficial. The requirement to reconcile balances reported by contractors with DoD general ledger account balances will be addressed in the Department's Form and Content procedures for reporting fiscal year 1992 financial activity.

- RECOMMENDATION 2: The GAO recommended that the Commander, U.S. Army Materiel Command direct Army Materiel Command leadership (1) to determine the specific reasons for the negative unliquidated obligations contained in existing balances, (2) to resolve each negative unliquidated obligation, (3) to prepare a corrective action plan to address systems and operating deficiencies that allow negative unliquidated obligations, and (4) monitor progress to help ensure that corrective actions are taken. (pp. 23-24/GAO Draft Report)

Now on pp. 11-12.

  DoD RESPONSE: Concur. On June 28, 1991, in response to a prior GAO report, the Defense Finance and Accounting Service and the Military Services formed a Joint Contract Accounting and Finance Process Review Group to develop joint action plans with the objective of finding, controlling, reducing and correcting the causes of negative unliquidated obligations. Although each of the four sub-recommendations have been addressed by the Group, and corrective actions have been taken by DoD activities, new negative unliquidated obligations continue to appear. The rate of new negative unliquidated obligations is of

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concern, and the Joint Group is continuing to find and resolve the causes.

- RECOMMENDATION 3: The GAO recommended that the Commander, U.S. Army Materiel Command require overpayments resulting from negative unliquidated obligations to be properly recorded in the accounting records as accounts receivable. (pp. 23-24/GAO Draft Report)

Now on pp. 11-12.

  DoD RESPONSE: Concur. Not later than August 31, 1992, the Commander, U.S. Army Materiel Command will be directed to issue guidance, requiring that overpayments resulting from negative unliquidated obligations be recorded as refunds receivable in accounting reports as of September 30, 1992.

- RECOMMENDATION 4: The GAO recommended that the Commander, U.S. Army Materiel Command follow Army Regulation 37-103 procedures in each disbursing office to limit access to blank Treasury checks and check signing machines. (pp. 23-24/GAO Draft Report)

Now on pp. 11-12.

  DoD RESPONSE: Concur. The GAO notes that immediate corrective action already was taken when each of the reported weaknesses was brought to the attention of local officials. In addition, within the next 90 days, the Army Materiel Command will inform all its disbursing offices of the related finding and required corrective action through its Audit Alert Network.

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